SB 457

Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 457 (Senator Guzzone)
Budget and Taxation

Income Tax Interest and Penalty Waiver Act of 2019

This emergency bill requires the Comptroller to waive all interest or penalties imposed on a taxpayer related to the payment of estimated income tax during calendar 2018.

Fiscal Summary

State Effect: General fund revenues decrease by $20.5 million annually in FY 2020 through 2023 as a result of a reduction in corporate and personal income penalty and interest revenues. Transportation Trust Fund (TTF) revenues decrease by $0.7 million and Higher Education Investment Fund (HEIF) revenues decrease by $0.3 million annually in FY 2020 through 2023. General fund expenditures increase in FY 2020 due to implementation costs at the Comptroller's Office. TTF expenditures decrease by $93,000 annually in FY 2020 through 2023 due to a reduction in local highway user revenue grants.

($ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
GF Revenue	($20.5)	($20.5)	($20.5)	($20.5)	$0
SF Revenue	($1.0)	($1.0)	($1.0)	($1.0)	$0
GF Expenditure	-	$0	$0	$0	$0
SF Expenditure	($0.1)	($0.1)	($0.1)	($0.1)	$0
Net Effect	($21.4)	($21.4)	($21.4)	($21.4)	$0.0

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: Local revenues decrease by $9.2 million annually in FY 2020 through 2023. Local expenditures are not affected.

Small Business Effect: Small businesses will benefit due to a reduction of penalties and interest paid.

Analysis

Current Law/Background:

Federal and State Estimated Tax Payment Requirements

Federal

Federal income taxes must be paid as income is earned or received during the year, either through wage and salary withholdings or estimated tax payments. Taxpayers who do not pay a sufficient amount of taxes during the year are subject to a penalty. The amount of estimated tax penalty assessed is equal to the amount of the underpayment multiplied by the applicable interest rate.

In order to avoid this penalty taxpayers must generally either (1) owe less than $1,000 in tax after subtracting their withholding and refundable credits or (2) pay withholding and estimated tax equal to the lesser of at least 90% of the tax for the current year or 100% of the prior tax year. Special rules apply to farmers and fishermen, certain household employers, and higher income taxpayers.

State Law

Taxpayers are subject to penalties and interest for the underpayment of State income taxes. Subject to exceptions, the Comptroller's Office advises that it will assess interest on a taxpayer unless the taxes throughout the year are equal to either:

- 90% of the tax required in the current tax year; or
- 110% of the tax paid in the prior year.

Interest or penalties may not be assessed if the unpaid tax is less than $500. In addition, special rules apply to individuals who have certain amounts of taxable income in other states and farmers and fisherman.

The Comptroller is required to assess interest from the due date of the tax to the date on which the tax is paid if a taxpayer fails to pay a tax due, fails to pay an installment when due, or pays an estimated amount that is less than certain thresholds. Interest may not be assessed on penalties. Chapter 322 of 2016 altered the calculation of the annual interest rate that the Comptroller sets for tax deficiencies and refunds. By October 1 of each year, the Comptroller's Office must set the annual interest rate for tax refunds and monies owed to the State for the next calendar year at a rate, equal to the greater of three percentage points above the average prime rate of interest in the previous fiscal year, based on information from the Federal Reserve Bank, or :

- 11.5% for calendar 2018;
- 11% for calendar 2019;

- 10.5% for calendar 2020;
- 10% for calendar 2021;
- 9.5% for calendar 2022; and
- 9% for calendar 2023 and each year thereafter.

The Comptroller is required to assess a penalty not exceeding (1) 10% of the unpaid tax when a return is not filed or tax not paid or (2) 25% of the amount of tax underpaid or underestimated. The Comptroller's Office advises that it assesses a penalty of 10% on businesses that underpay estimated taxes but does not currently assess a penalty on individuals. In tax years 2007 through 2013 the Comptroller assessed on average $144.7 million in penalties and interest, of which $122.5 million was from the personal income tax with the remaining $22.3 million from the corporate income tax. Interest comprised about three-quarters of the total with penalties comprising the remaining one-quarter.

Recent Federal Law Changes Have Increased Uncertainty over Estimated Taxes

The federal Tax Cuts and Jobs Act of 2017 (Public Law 115-97) was signed into law on December 22, 2017, and enacted significant changes to federal taxes, including the personal income tax. The Comptroller's Office estimates that as a result of the federal Act 71% of Maryland taxpayers will pay less in federal taxes, 13% will pay more, and the remaining 16% will not be impacted. In total, federal taxes paid by Maryland residents will decrease by $2.75 billion – reflecting a decrease of $3.54 billion paid by 2.0 million taxpayers and an increase of $782 million paid by 376,000 taxpayers. The Comptroller's Office estimates that the federal legislation will not impact the State and local income taxes paid by 71% of all taxpayers. About 6% of taxpayers will pay less and about 23% will pay additional State and local income taxes. In total, the Comptroller's Office estimates that 9% of all taxpayers will have a net increase in federal, State, and local tax liabilities, and the remaining 91% of taxpayers will have no change or a net decrease in federal, State, and local tax liabilities.

Although the federal Act will reduce overall federal and State taxes, given its complexity and the fact that the Act eliminated several benefits, it has increased uncertainty over tax year 2018 liabilities. In addition, the Internal Revenue Service (IRS) did not begin altering withholdings until late February and only accounted for some, but not all, of the changes.

In January 2019, IRS announced that it will waive the federal estimated tax penalty for certain taxpayers whose tax year 2018 federal income tax withholding and estimated tax payments were less than the required amounts. IRS is generally waiving the penalty for any taxpayer who paid at least 85% of their total tax liability during the tax year. This relief is designed to help taxpayers who were unable to properly adjust their withholding and estimated tax payments in light of the changes enacted by the federal Tax Cuts and Jobs Act of 2017.

State Revenues: The bill requires the Comptroller to waive all interest or penalties imposed on a taxpayer related to the payment of estimated income tax during calendar 2018. As a result, general fund revenues will decrease by an estimated $20.5 million annually in fiscal 2020 through 2023. TTF revenues will decrease by $689,000 and HEIF revenues will decrease by $283,000 annually in fiscal 2020 through 2023. **Exhibit 1** shows the estimated impact of the bill on State and local revenues.

Exhibit 1
State and Local Revenue Impacts
($ in Millions)

	FY 2020	**FY 2021**	**FY 2022**	**FY 2023**	**FY 2024**
State Revenues					
General Fund	($20.5)	($20.5)	($20.5)	($20.5)	$0.0
HEIF	(0.3)	(0.3)	(0.3)	(0.3)	0.0
TTF	(0.7)	(0.7)	(0.7)	(0.7)	0.0
Total	**($21.5)**	**($21.5)**	**($21.5)**	**($21.5)**	**$0.0**
Local Revenues					
Income Tax	($9.1)	($9.1)	($9.1)	($9.1)	$0.0
LHUR	(0.1)	(0.1)	(0.1)	(0.1)	0.0
Total	**($9.2)**	**($9.2)**	**($9.2)**	**($9.2)**	**$0.0**

HEIF: Higher Education Investment Fund
LHUR: local highway user revenue
TTF: Transportation Trust Fund

This estimate is based on the average interest and penalties assessed by the Comptroller's Office, adjusted for projected growth and changes in the interest rate assessed in each year. Based on the existing collection of interest and penalties assessed, it is assumed that penalties and interest waived by the bill would have been collected by the Comptroller's Office over four years.

State Expenditures:

TTF Expenditures

TTF expenditures for local highway user revenue grants will decrease as a result of a reduction in corporate income tax penalties and interest. TTF expenditures will decrease by $93,000 annually in fiscal 2020 through 2023.

Administrative Costs

The Comptroller's Office reports that it may incur significant implementation costs in fiscal 2020 in order to waive interest and penalties related to estimated income tax payments. These costs include data processing changes and documentation and auditing costs in order to identify only those penalties and interest related to estimated income tax payments.

Local Revenues: As shown in Exhibit 1, local revenues will decrease by $9.1 million annually in fiscal 2020 through 2023 due to a reduction in penalties and interest assessed against the local income tax. Local highway user revenues will decrease by $93,000 in fiscal 2020 through 2023.

Additional Information

Prior Introductions: None.

Cross File: HB 457 (Delegates Korman and Krebs) - Ways and Means.

Information Source(s): Comptroller's Office; Department of Legislative Services

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